CHINA'S ECONOMY

Reading their lips

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Worried about their money

"STATESMANLIKE" is the term for which editorial-writers reach when describing Chinese leaders' resolve not to devalue their currency, the yuan. China's selflessness, Britain's prime minister, Tony Blair, has said, is something to which tribute should be paid. People fear that if China devalued, Asia would succumb to another round of debilitating devaluations, bringing down even the Hong Kong dollar. In fact, China is following its own self-interest. It knows that to devalue the yuan could do more harm than good.

Certainly, some inside China are lobbying hard for devaluation: China's ship-builders, for instance, which have been clobbered by the fall in the currencies of South Korea and (until recently) Japan. Moreover, some foreign observers argue that deflationary pressures will make devaluation irresistible, for lower export prices would help combat them. They also point to growing capital flight this year, and a weakening yuan on the black market, as signs that the government's nerve is not expected to hold.

Currency controls, over $140 billion in foreign reserves, and a trade surplus of probably over $50 billion this year: all are reasons for believing that the government will not devalue. Now there is a new reason: concern about China's foreign debt.

This issue has been brought into sharper focus by the recent closure of Guangdong International Trust & Investment Corporation (GITIC), with $2.4 billion in foreign debts. GITIC is one of a network of such groups, mostly owned by provincial governments, that have combined foreign debts of over $10 billion and a history of squandered investments. Now, the central government is set to close more of them. That makes foreign lenders even more nervous; most are stopping new loans altogether. A devaluation would worry them more, because it would undermine the ability of all Chinese entities to pay back debt.

By the official count, neither China nor its lenders should have all that much to worry about. The country's debt ratio—the ratio between external debt and hard-currency income—stands at a comfortable 75% or so, well below the 100% level that starts to ring alarm bells. Moreover, foreign direct investment accounts for four-fifths of all capital inflows to China. The country is not as reliant on short-term borrowing as were its neighbours.

Yet one lesson from the past 15 months is that official debt figures can be gross understatements. The question is how much bigger than the official count are China's reported debts of around $120 billion. Half as much again is a reasonable first guess. Several types of borrowing do not show up in the data. For instance, lending by mainland branches of foreign banks does not, though it amounted to $27 billion in mid-1998.

There are also borrowings by "red chips"—Hong Kong-registered arms of central, provincial or local governments listed on the territory's stockmarket. Strictly, red chips are not mainland firms. But much of what they borrow has been invested in China, so part of their debt ought to count in China's foreign-currency exposure. Also, some foreign direct investment, particularly from Hong Kong, is actually lending in disguise. In several mainland infrastructure projects, the lenders get guaranteed foreign-currency returns: debt by any other name.

China's rising foreign debts clearly worry the authorities. Early this year they tightened rules on the amounts mainland companies can borrow. The State Administration for Foreign Exchange (SAFE) has rattled off a series of measures to plug the holes in China's (officially closed) capital account. One official estimates that a quarter of outflows through the current account is in fact disguised capital flight: dollars earned from false invoicing, illegal foreign-exchange deals and other nefarious activities. With capital flight reckoned to be as big as inward flows of foreign investment ($35 billion-45 billion a year), this official says that plugging just half of the foreign-exchange leaks would be a signal victory.

Further instances of ill-judged lending may well emerge. But a yuan devaluation would greatly aggravate China's foreign-debt problem. It is another reason to think that Communist rhetoric, this time at least, has a ring of sincerity to it.